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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 547.

NEW COLONIAL ICE CO., INC.,
Petitioner,

against

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR PETITIONER-APPELLANT.

EDWARD G. GRIFFIN,
JOSEPH STERLING,
Attorneys for Petitioner-Appellant.

GALLO & ACKERMAN, Inc., 142 Liberty Street, Telephones—Rector 2-5356-7

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Opinions Below.

The opinion of the Board of Tax Appeals is at Record, page 34. The opinion of the Circuit Court of Appeals for the Second Circuit is at Record, pages 43 to 47 inclusive.

Jurisdiction.

This appeal is brought to this Court by petition for a writ of certiorari filed herein on the 24th day of October, 1933, which petition was granted by order of this Court filed herein on December 4th, 1933.

Statutes Involved.

These will be found in the appendix, infra, pages 21-24.

Question Presented.

Where a successor corporation has the same assets and liabilities, the same classes of stock and of the same denominations as the predecessor company, the same amount of stock issued, and held by individuals in the same proportions as these same individuals held stock in the predecessor corporation, shall the separate legal entities be disregarded so as to permit the successor corporation to avail itself of the net losses of the prior year of its predecessor corporation in the manner allowed by Section 204, Subdivision "B", of the Revenue Act of 1921?

Facts.

The agreed statement of facts upon which this case was submitted, indicates that the Colonial Ice Corporation (hereinafter referred to as the "old company") was a New York Corporation, incorporated on April 20th, 1920, with an authorized capital stock of $750,000, consisting of 6,500 shares of preferred stock, of $100.00 par value, and 20,000 shares of common stock, of $5.00 par value (R., 11).

The corporation had been promoted by one Edmond C. Turner, his wife, Florence Turner, and one, Michael De. Carlo. These individuals, through a stock selling campaign, sold the stock among small ice and coal dealers in New York City, in units of one share of common and one share of preferred, at a sales price per unit of $100 (R., 11).

A building site was purchased, extensive contracts were entered into for structural improvements and for

the installation of refrigerating machinery. The largest contract was with the DeLaVergne Machine Company. Said Company and other creditors who installed equipment retained title to the equipment so installed.

A point was reached in August of 1921, when the plant was in a condition to operate at about forty per cent. of its capacity. At that time, it owed creditors approximately $285,000 and was in no financial condition to liquidate this indebtedness (R., 11).

The inability of the Company to meet its indebtedness resulted in the formation of a Creditors' Committee, which Committee thereafter acted through the DeLaVergne Machine Company,—the largest creditor. A Stockholders' Committee was also formed (R., 11, 12).

The investigation disclosed the issuance of spurious stock and stock for which no consideration was received, and of which stock no entries had been made in the records of the Company (R., 12).

This situation brought about the resignation of Mr. Turner, the surrender and cancellation by him and others of stock improperly issued, and the ascertainment by the respective Stockholders' and Creditors' Committees that there were legitimately outstanding 3,385 shares of preferred and a like number of common stock (R., 12).

Negotiations between the creditors and stockholders finally resulted in an agreement between the Old Company (referred to in the agreement as the "Ice Corporation") and the DeLaVergne Machine Company, acting on behalf of itself and other creditors (R., 12).

The agreement recites the indebtedness to the Creditors; the inabilitiy of the Company to pay; the necessity of bringing the plant to full capacity "so that it may operate efficiently, economically and with profit"; that new equipment was required, for which the corporation was without funds; that a "scheme of re-organization" had been proposed, under which the creditors agreed to complete said plant and grant to the Ice Corporation

reasonable time within which to pay its present indebtedness and also the cost of said additional plant, and that the Ice Corporation was desirous of accepting said "scheme of reorganization."

After these recitals, there followed covenants and provisions of the Contract, in substance as follows:

The Ice Corporation agrees that it will cause to be organized under the New York Laws, a new company to be called "New Colonial Ice Co., Inc." Its capitalization was to consist of 6,000 shares of preferred stock of $100 par value and 20,000 shares of common stock at $5.00 par value (R., 15, 16).

The Ice Corporation was to enter into a contract with the New Colonial Ice Co., Inc., and to sell to it all of its assets; the New Company to assume and pay all of the indebtedness of the Old Company; as further consideration for said transfer, the Ice Corporation (the Old Company) was to receive about 3,400 shares of the preferred stock, and voting trust certificates for about 3,400 shares* of common stock of the New Company (R., 16).

In the "Third" paragraph of the agreement, the creditors agreed to complete the plant, at a cost of approximately $132,000, and to extend the time of the payment of both old and new indebtedness for a period of not to exceed five years.

This paragraph contains safeguards to insure that all profits from the operation of the plant shall be used to pay the indebtedness; and until such full payment the creditors shall have control of the management of the Company through the Voting Trust of the common stock; that the creditors were to be represented by four, and the stockholders by three Directors (R., 16, 17).

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*Number of legitimate shares preferred and common of old company later ascertained to be 3,385 of each. Accordingly only these amounts issued (R., 13).

Paragraph "Fourth" provides for the creditors relinquishing management and returning the stock, upon the indebtedness being paid.

A new company was thereupon formed under the laws of the State of New York. Article X of this certificate of incorporation* states as a specific purpose, that it was to "carry on the business of the Colonial Ice Corporation." Also, it was to "assume or otherwise provide for all or any part of the liabilities of said corporation."

Preferred stock in the amount of 3,385 shares (being the identical amount of the legitimate preferred stock outstanding in the Old Company) was issued in one certificate to the Old Company. The certificate was reassigned by the Old Company and re-delivered to the New Company with appropriate directions that it should cancel said certificate and issue and deliver certificates for such preferred stock to such persons, firms, or corporations as the Old Company might direct (R., 13).

A certificate for 3,385 shares of the common stock of the New Company (being the identical amount of the legitimate outstanding common stock of the Old Company) was issued to Louis Baron, Fred Nolte, and Robert D. Eggleston, as Trustees pursuant to said Exhibit "A," annexed to Agreed Statement of Facts (R., 13).

Said voting trustees issued voting trust certificates for 3,385 shares to the Old Company. The Old Company thereupon endorsed and re-delivered said certificate for 3,385 shares to the Voting Trustees, with directions that they should cancel said Certificate and issue Voting Trustees' Certificates to such persons, firms or corporations as the Old Company might thereafter direct (R., 13).

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*The certificate of incorporation of the new company was attached to and formed part of agreed stipulation of facts. It was inadvertently omitted from the printed record. A certified copy of the certificate will be submitted on the argument.

The stockholders of the Old Company, with the exception of stockholders owning 247 shares of each class of stock, surrendered their stock to the Old Company and received from the New Company, as agent for and, on direction from the Old Company, share for share of preferred stock of the New Company, for preferred stock in the Old Company, and received from said voting trustees, on direction of the old company, voting trustees' certificates of common stock in the New Company, share for share, for the common stock so surrendered (R., 13).

The New Company continued to hold the 247 shares of preferred stock, and the Trustees continued to hold 247 shares of voting trust certificates in the New Company available to those stockholders of the Old Company who had not as yet turned in their shares in the Old Company, pursuant to the plan of exchange. Although up to and including December 31, 1922, these 247 shares of each Class of stock were unexchanged, in subsequent years the exchange was effectuated (R., 13, 14).

The Voting Trust Agreement continued until April 9th, 1927, at which date it came to an end, and the common stock was issued to holders of the respective voting trust certificates, and the creditors relinquished their control (R., 14).

In 1921 the Old Company sustained a statutory net loss of $36,093.19.

From January 1st to April 13th, 1922, the Old Company sustained a statutory net loss in the sum of $10,338.90 (R., 14).

For the period from April 14, 1922 up to and including December 31, 1922, the net income of the New Company was the sum of $48,763.43 (R., 14).

For the calendar year of 1923 the net income of the New Company was in the amount of $56,242.55 (R., 14).

On consolidated returns filed by the New Company, there were deducted from its respective net income, the losses so sustained by the Old Company.

The Respondent's notice of deficiency disallows this deduction. These proceedings came before the United States Board of Tax Appeals on a petition for a redetermination of the alleged deficiency. The Board overruled the contentions of the petitioner and found deficiencies in the amounts indicated in the decision (R., 37).

On petition to review, the United States Circuit Court of Appeals, Second Circuit, affirmed the Board of Tax Appeals (R., 43-47).

ARGUMENT.

The petitioner was warranted in deducting from its net income of 1922 and 1923, losses sustained by the Colonial Ice Corporation in 1921 and from January 1st, 1922 to April 13th, 1922. Disregarding the legal fiction, the petitioner was the same taxpayer as its predecessor corporation, Colonial Ice Corporation.

The opinion of the learned Court below, is predicated on the premise that one corporation may never claim to be the same "taxpayer" as another corporation, as the word "taxpayer" is used in Subdivision "B" of Section 204, Revenue Act of 1921. Holding this opinion, the Court below gave no consideration to the factual circumstances which conclusively established that for all practical purposes, the new corporation was the same entity as the old one and therefore the same taxpayer. The Court below expressly declined to follow Pioneer, Pole & Shaft Co. v. Commissioner of Internal Revenue, 55 Fed. (2d) 861 (C. C. A. 6), and H. H. Miller Industries Co. v. Commissioner, 61 Fed. (2d) 412 (C. C. A. 6).*

*Industrial Cotton Mills Co. v. Commissioner, 61 Fed. (2d) 291 (C. C. A. 4) and Western Maryland v. Commissioner, 33 Fed. (2d) (C. C. A. 4) 695, 697, hereinafter discussed, are in accord with the principle recognized by the Sixth Circuit and repudiated by the Second Circuit.

The rule as adopted in the 4th and 6th Circuits, that in applying income tax laws, substance shall prevail over form and distinct corporate entities shall be ignored when in fact, the corporations are one, is in accord with the decisions of this Court.

In Southern Pacific Co. v. Lowe, 247 U. S. 330, the plaintiff in error was taxed as income on dividends declared out of the surplus of the Central Pacific, a corporation of which plaintiff in error owned all of the stock. The surplus out of which the dividends had been declared had been accumulated prior to the effective date of the Income Tax Act of October 3rd, 1913. The payment of the dividend was only constructive, being carried into effect by bookkeeping entries which reduced the surplus of the Central Pacific and reduced apparent indebtedness of the Southern Pacific to the Central Pacific. This Court looked to the actualities, ignored corporate fictions, and permitted recovery of the tax previously paid.

In Gulf Oil Corporation v. Lewellyn, 248 U. S. 71, a transaction was held not to be taxable wherein a holding company took over the earnings and the surplus of its subsidiaries through dividends declared, the dividends being paid by transferring debts due to the subsidiary from another wholly owned subsidiary of the holding company. The result was reached notwithstanding that the court recognized "that the petitioner and its subsidiaries were distinct beings in contemplation of law."*

Weiss v. Stearn, 265 U. S. 242, and Marr v. United States, 268 U. S. 536, are cases where the taxpayer was a stockholder who received substituted securities on the reorganization of a corporation in which he held stock.

*In the Southern Pacific Company case, the Southern Pacific was physically in possession and operated the business of its subsidiary. In the Gulf Oil Corporation case, supra, the opinion states, "The petitioner did not itself do the business of its subsidiaries and have possession of their property as in Southern Pacific Co. v. Lowe, supra, but the principle of that case must be taken to cover this" (p. 73).

In Weiss v. Stearn, supra, upon a reorganization, stockholders received cash for half of their respective holdings, and for the other half, received the same proportionate interest represented by stock, in a new corporation which purchased and took over all of the assets and assumed all of the liabilities of the old company.

The collector had ruled that each stockholder sold his entire holding, and assessed respondent accordingly for the resulting profits. This Court held that the transaction merely amounted to a financial reorganization under which each old stockholder disposed of half of his interest and retained half.

In reaching the determination that the stockholder was in effect retaining half of his former interest, this court of necessity ignored the corporate distinction between the old company and the reorganized company.

In Marr v. United States, supra, while the result was adverse to the taxpayer, the prevailing opinion expressly recognizes the principle that where the business enterprises as conducted remain exactly the same and the corporate identity is preserved notwithstanding reorganization, the courts would treat the two corporations as though they had been the same. However, in the Marr case the reorganized company was organized under the laws of a state other than its predecessor. The succeeding corporation had a 6% non-voting preferred stock, whereas its predecessor had 7% voting stock. Its common stock was subject to the priority of $20,000,000 preferred, whereas the predecessor corporation had common stock subject only to $15,000,000 preferred. The court therefore found, as a factual issue, that "the case at bar is not one in which after the distribution, the stockholders have the same proportional interest of the same kind in essentially the same corporation" (p. 542).

This Court likewise took note as an important although perhaps not controlling circumstance, the fact that the two corporations were organized in different states.

In Burnett v. Commonwealth Improvement Co., 287 U. S. 415, an estate contended that for tax purposes, it was identical with a corporation of which it owned all the stock and debentures. While deciding against the taxpayer, this court again recognized that where the facts warranted, the corporate fiction might be ignored. In the opinion, the following language occurs:

> "While unusual cases may require disregard of corporate form, we think the record here fails to disclose any circumstances sufficient to support the petitioner's claim" (p. 419).

Again in Dalton v. Bowers, 287 U. S. 404, where the claim was asserted by stockholders in a corporation that the corporate entity should be ignored and the claimed loss of the corporation should be treated as the loss of the stockholders, the court recognized the principle for which we contend. It held however, that the facts as disclosed by the record were not in harmony with the argument advanced.

Rule Above Discussed, Followed in Circuit Court of Appeals, 4th, 6th and 3rd Circuits.

Industrial Cotton Mills v. Commissioner, 61 Fed. (2d) 291 (C. C. A. 4), also recognizes and applies the principle in a case where the taxpayer claimed the right to deduct from the profits of one year, the losses of its predecessor corporation in a prior year. In its essentials, this case is strikingly like the case at bar. There, the petitioner sought to deduct, in a consolidated return filed on its behalf and on behalf of Blue Buckle Cotton Mills, Inc., losses sustained by the Blue Buckle in 1921. The Blue Buckle, which was organized in 1920, sustained losses in that year of over $500,000. This loss resulted in financial embarrassment; early in 1921, it elected as directors, members of a creditors' committee and placed them in charge of its business. In November, 1921, the Industrial was organized as a holding com-

pany. It took over certain stock of and all claims outstanding against the Blue Buckle and issued its own stock therefor. In June, 1922, the Blue Buckle and Industrial were merged, as a result of which, the holding of stock and the claims against the Blue Buckle were extinguished and the property of the latter was vested in the Industrial.

The Board of Tax Appeals declined to permit the deduction, holding, that by the merger, a distinct corporate entity was created.

In reversing, the Circut Court of Appeals (4th) held, at page 292:

> "We think that the decision of the Board sacrifices substance to form. There was throughout the years in question but one income-producing property and but one group of people who owned and operated it, i. e., the stockholders and creditors of the Blue Buckle, who as a result of the method of financing adopted became stockholders of the Industrial."

In Pioneer Pole and Shaft Co. v. Commissioner, 55 Fed. (2) 861 (C. C. A. 6), a New Jersey company reincorporated in Ohio. The New Jersey company had issued stock for good will on certain appraised valuation. In determining the income and excess profits tax, the Commissioner declined to make allowance for goodwill as an item of invested capital in accordance with the appraisement on the organization of the original company. The Sixth Circuit held that corporate identity may be recognized, notwithstanding the creation of a new corporation "technically a distinct legal entity" to take over the property of the old corporation and that on the facts disclosed there was such corporate identity.

In H. H. Miller Industries Co. v. Commissioner, 61 Fed. (2d) 412 (C. C. A. 6), the 6th Circuit had before it the question whether the petitioner should be allowed a de-

duction for exhaustion of patent as of its March 1st, 1913 value, or whether the allowable deduction should be based upon the cost to the petitioner of the patent when the petitioner took over the assets of a predecessor corporation. The petitioner was an Ohio corporation; it succeeded a New Jersey corporation, took over all the assets, and assumed liabilities; the stock of the New Jersey corporation was exchanged share for share for that of the Ohio corporation. The name and capital structure of the two corporations and the stockholders remained identical.

The ultimate question presented, was whether on the facts before it, the court should disregard the separate corporate entities, and for tax purposes treat the two corporations as though they had been one. The 6th Circuit regarded the Southern Pacific Co. v. Lowe, supra, Gulf Oil Corporation v. Lewellyn, supra, and Weiss v. Stearn, supra, as authorities justifying it in ignoring the form and regarding only the substance. Accordingly, the petitioner's claimed deduction was allowed.

In Phillips v. Lyman H. Howe Films Co., 33 Fed. (2d) 891 (C. C. A. 3), the 3rd Circuit had before it the question whether a succeeding corporation was the same "taxpayer" as its predecessor corporation within the meaning of Section 284 (G) of the Revenue Act of 1926. This section provides for the filing of a waiver by the taxpayer on or before June 15th, 1926 in respect of taxes for the taxable year of 1920 or 1921, and in the event that such waiver be filed, that credits or refunds for said years shall be allowed if the claim therefor is filed within a certain specified time. In the circumstances there disclosed, the court held that there was an unbroken corporate continuity—so much so, that the new corporation might be regarded as the old corporation and as the "taxpayer", authorized to file the waiver.

In Western Maryland Railway Company v. Commissioner, 33 Fed. (2d) 695 (C. C. A. 4) there was involved

the right of a corporation organized on a merger to avail itself of a deduction on account of certain bond discounts to which one of the merged corporations would have been entitled. In this case, which antedated the Industrial Cotton Mills Co. case, the court found factually that the new corporation and the old corporation, were the same. It therefore treated the two corporations as one and declined to recognize the technical legal differences.

While the Board of Tax Appeals may have been overcritical in seizing upon unimportant differences in denying identity of corporate entities, the Board has, none the less, recognized the general rule. Thus, in Standard Silica v. Commissioner, 22 B. T. A. 97, the Board discussed Weiss v. Stearn, supra, and Marr v. United States, supra, and in its opinion, commented upon these two cases in the following language:

> "If the foregoing cases just discussed contain any controlling principles relative to the issue here presented, it would seem to be that where two or more corporations reorganize, the business and assets of which are not materially changed and the stockholders receive nothing actually severed from their original capital interest,—nothing differing in substance from what they already had, then in such a case the legal distinction in corporate entity should be ignored. See dissenting opinion, Marr v. United States (supra)."

In So Far As Recognizing Or Ignoring Separate Corporate Entities, the Same Principles Should Apply In Construing the Word "Taxpayer" As Used In Section 204 (B), As Is Adopted In Applying Other Sections of the Tax Law.

In the instant case the opinion of the 2nd Circuit stresses the argument that "a taxpayer who seeks to charge off a loss suffered in an earlier year, must do so by virtue of some statute permitting the deduction and must bring himself within the terms thereof, otherwise his losses are confined to the current year" (R., 81).

The same argument was stressed by respondent in the brief below, and we apprehend it will be urged here. There can be no quarrel with this statement as a general principle. However, it has no application to the instant case, and it nowise aids the solution of the question involved.

To meet the requirement of the principle stated, we of course, point to Section 204 (b). This brings us back to the main argument as to whether the word "taxpayer" as used in that provision shall receive a liberal and reasonable construction, or whether the word shall be construed literally and the section narrowly. If it be the government's argument that the courts should adopt one formula in determining who is the taxpayer when the question of a taxable gain is involved, and a different formula when the question of deductable loss is to be considered, we think such a position is untenable.

Neither the statute itself, precedent nor reason, supports such a proposition. It would be unreasonable to say that in construing one provision of the tax law, the court shall face actualities, ignore legal fiction, and treat as one, two separate corporate entities when the facts justify it, and in construing another section of the law with the same corporations and the same facts before it,

the court should blind itself to the facts, ignore the actualities and pay heed to what is really a legal fiction.

It will be observed from the facts in the numerous cases where the principle contended for was accepted by this court and was adopted by the Circuit Court of Appeals, the sections of the income tax law under consideration and the ultimate questions involved, were varied.* As far as counsel's investigation disloses, this court has not been required to pass upon the question as to whether it will treat two corporations as one and as constituting the same "taxpayer" under Section 204 (b), where in fact, the corporations were essentially the same unit. We submit that the same reasoning which requires the application of the rule in circumstances appearing in the cases cited, requires its application in the instant case.

The Facts Disclose Identity For All Practical Purposes Between This Petitioner and Its Predecessor.

In none of the cases which counsel have read, has there been preserved so completely, identity between the old and the new, as in the instant case. The new company took over the assets and assumed the liabilities of the old (R., 13). Theretofore outstanding in the old company, were 3,385 shares of preferred and a like number of common stock; the new company issued the same amount of preferred, the same amount of common (R., 13). The old company's preferred stock were in denominations of $100; its common stock in denomina-

*In cases other than income tax cases, courts, both Federal and State, have recognized a claim by a corporation of practical identity with a predecessor corporation where the facts supported such claim. (Shapleigh v. San Angelo, 167 U. S. 646; Alden v. Wright, 175 N. Y. A. D. 692; First Society of M. E. Church v. Brownell, 5 Hun 464; People ex rel. U. S. Grand Lodge v. Payn, 161 N. Y. 229; People ex rel. Consolidated Kansas City Smelting & Refining Co. v. Secretary of State, 13 N. Y. A. D. 50; Jones v. Frances, 70 Wash. 676; McCann v. Children's Home Society, 176 Cal. 359.)

tions of $5.00 (R., 11). Likewise, the preferred and common stock of the new company were of the denominations of $100 and $5 respectively (R., 12).

The same individuals were beneficially interested in the stock, both preferred and common, of the new company, in the very same proportions as they had been in the stock of the old company.* Both corporations were organized under the laws of the State of New York. The old company, from August of 1921, had been managed by "officers and directors of the creditors' choosing" (R., 12). The new company was under the control and management of the creditors through a voting trust agreement of which the DeLaVergne Machine Company (representing the creditors) acted as the voting trustee, and whereby the creditors had the control of the Board of Directors (R., 17). The certificate of incorporation of the new company specifically states as one of its purposes, that it was to "carry on the business of the Colonial Ice Corporation." The agreement between the creditors and the old company, referred to in the agreement as the "ice corporation", refers to the plan as "a scheme of reorganization". The purpose was to "grant to the ice corporation (the old company), reasonable time within which to pay its present indebtedness and also the cost of said additional plant" (R., 15). The surrounding circumstance, as well as the agreement between the old corpo-

*Up to and including December 31, 1922, the 247 shares of each class of stock were unexchanged although in subsequent years the exchanges were effectuated and the stockholding thereby became identical. For all practical purposes and as of December 31, 1922, the stockholdings may be regarded as identical. Stockholders who had neglected to effectuate the exchange, held 247 shares of preferred and common of the old corporation which had no liabilities, and which had as its only asset, the right to call upon the trustee for the 247 shares of preferred and common of the new company upon surrender of the like amount of the preferred and common of the old. The stockholders of the old company, each on his own behalf, had the right to effect the exchange. To all intents and purposes, the equitable ownership which they then had (later converted into legal ownership by an actual exchange), may be considered as proportionate ownership in the new company.

ration and its creditors, disclose that the petitioner was merely a vehicle by which creditors might more conveniently hold in trust, the control and management of the assets of the old company and its operation, to the end that debts due to these creditors might be paid.

The points of difference between the old and new company were so trivial and inconsequential, as to accentuate the fact that fundamentally, the companies were the same. The old company had an authorized capital stock of $750,000; the new company an authorized capital of $700,000, the difference being that the new company had only authorized 6,000 shares of preferred as against the old company's 6,500 shares. Inasmuch as the old company had outstanding only 3,385 shares of preferred, this reduction of authorized capital stock easily could have been effected by the old corporation without essentially changing its corporate structure.

The opinion of the Board of Tax Appeals comments on the fact that the certificate of incorporation of the petitioner was submitted in evidence, not that of the old company, and therefore, the Board was unable to make proper comparison of their likenesses or differences (R., 36). The two certificates were matters of public record. Undoubtedly, the government's representatives would have offered the old certificate in evidence had it deemed a material difference existed. In the absence of evidence to the contrary, we are warranted in assuming that where a new corporation is formed under the laws of the same state, to take over the business of its predecessor, that it has "presumably the same powers as the old" (Marr v. United States, 268 U. S. 538, 541).

The opinion* of the Board of Tax Appeals as a further ground for holding that the new corporation was some-

*In the opinion of the Board of Tax Appeals, there is the statement "the preferred stock and trustees' voting certificates for common stock of the new company which were held available for exchange when the minority saw fit to turn in its stock, were not held by the old company,

(*Footnote continued on next page.*)

thing essentially different from the old, refers to the fact that the old company, in addition to its financial difficulties, found that a large number of shares had been issued without consideration, and that "in this situation, it was important from the point of view of both the creditors and the bona fide stockholders, that the new corporation to which the assets would be transferred, would be something entirely different from the old corporation, spurious stock of which might still be in existence" (R., 35, 36).

Obviously, the motive which actuated the formation of the new corporation and the method which they adopted, created nothing "entirely different." If stocks were genuine, the holders of stock could not be deprived of their rights by reason of the reincorporation. On the other hand, if stocks were spurious, the holders thereof would have had no greater right in the old company than in the new. The change was evidently dictated by legal tidiness; reincorporation was regarded as the easiest way to remedy the slovenly condition in which the stock of the old company had been handled. It made detection of spurious stock more certain. It was merely the adoption of a new uniform; a change in the outer garb, the substance within being unchanged.

(*Footnote continued from previous page.*)

but by the new" (R., 35). Here, the Board indulged in certain constructions of the stipulated facts not justified by the record. Upon the formation of the new company, the 3,385 shares of preferred, and a like amount of common were issued to the old company. The old company thereupon retransferred the preferred stock to the new company and the common stock to the voting trustee with appropriate directions that preferred stock and voting trust certificates should be issued "as the old company might thereafter direct" (R., 13). The old company did not part with title to either of these classes of stock when it re-endorsed them to the new company and the voting trustees, respectively; the re-transfers were acts of convenience merely. The new company and the voting trustee acting as agent for, and under the direction of the old company in the contemplated retirement of stock.

In the cases heretofore cited and discussed, far more substantial differences have been ignored. As for example, where debts have been reduced and capital increased by the conversion of liabilities into stock (Industrial Cotton Mills Co. v. Commissioner, supra). In H. H. Miller Industries Co. v. Commissioner, supra, the fact that the new corporation was formed in one state and the old corporation in another had been regarded as no longer controlling. In the 2nd Circuit, the continuity of corporate entity was held not to be effected by the fact that the new company was permitted to manufacture products in addition to silk—the product to which the charter of the old company had been confined. Commissioner v. Sansome, 60 Fed. (2d) 931.

It is respectfully submitted that the determination of the Circuit Court of Appeals should be reversed and the case remanded with directions for appropriate allowances to the petitioner.

Respectfully submitted,

EDWARD G. GRIFFIN,
Attorney for Petitioner.

JOSEPH STERLING,
of Counsel.

APPENDIX.

REVENUE ACT OF 1921, C. 136, 42 STAT. 227.

SEC. 2. That when used in this Act—

(1) The terms "person" includes partnerships and corporations, as well as individuals;

* * * * *

(9) The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act;

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SEC. 202. (c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use;

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another

corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation (however effected); or

(3) When (A) a person transfers any property, real, personal, or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or (B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in substantially the same proportion as their interests in the property before such transfer. For the purposes of this paragraph, a person is, or two or more persons are, "in control" of a corporation when owning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

(d) (1) Where property is exchanged for other property and no gain or loss is recognized under the provisions of subdivision (c), the property received shall, for the purposes of this section, be treated as taking the place of the property exchanged therefor, except as provided in subdivision (e);

(2) Where property is compulsorily or involuntarily converted into cash or its equivalent in the manner described in paragraph (12) of subdivision (a) of section 214 and paragraph (14) of subdivision (a) of section 234, and the taxpayer proceeds in good faith to expend or set aside the proceeds of such conversion in the form and in the manner therein provided, the property acquired shall, for the purpose of this section, be treated as taking the place of a like proportion of the property converted.

* * * * * *

SEC. 204. (a) That as used in this action the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) The gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

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SEC. 240. (c) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.